

To Prenote or Not: That Is the Question

BY GARY NESBITT, AAP

Regular readers of Direct Deposit Directions have certainly seen articles about whether or not prenotes should be sent for direct deposit of payroll. There are “champions” for both sides of this issue.

Companies that have been offering direct deposit for years may have elected to no longer prenote new enrollments. However, there may be new scenarios where sending the prenote may be a good quality-assurance tool, particularly for those companies that have moved to employee self-service for many payroll and benefits activities. When the employee is allowed or required to enter their bank or credit union information, the number of errors may increase over the numbers seen when trained payroll staff handled the direct deposit enrollment process.

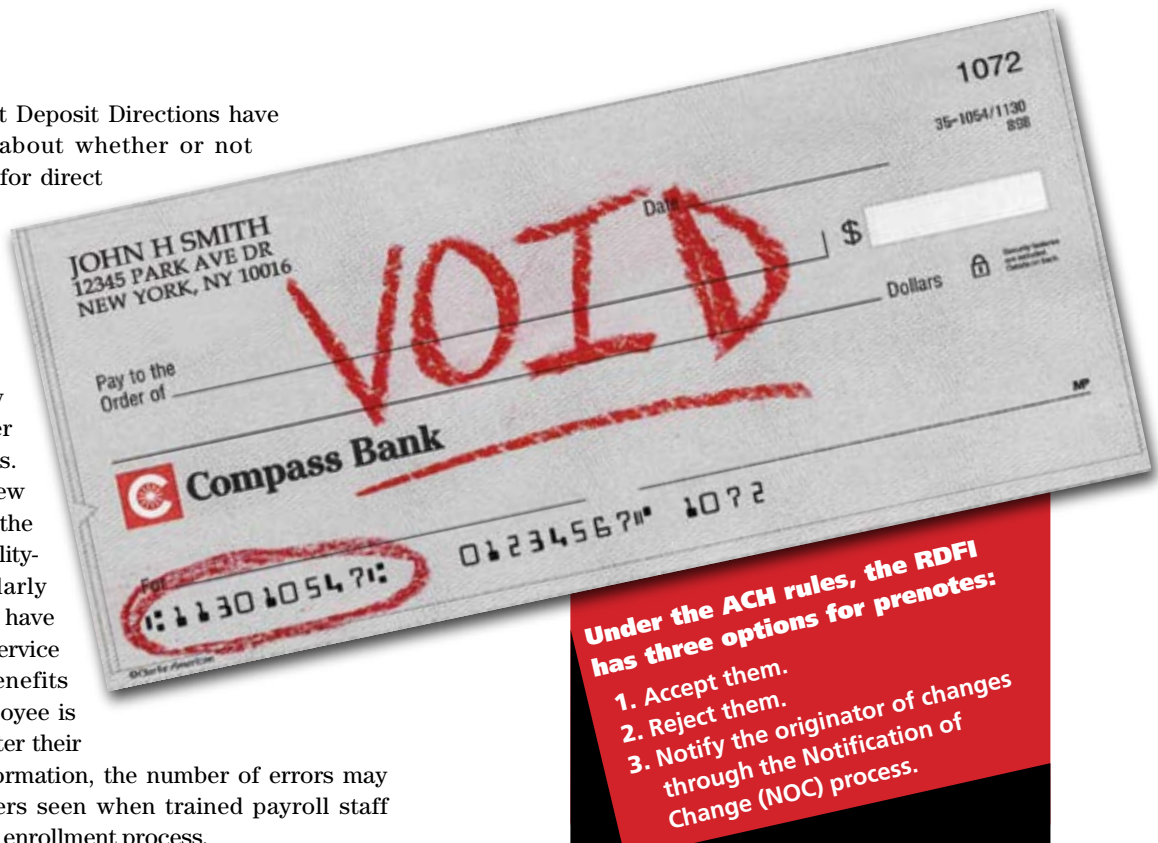
The Purpose of Prenotes

Perhaps we should first review what a prenote is and what it isn't. My experience is that there is often confusion or misconceptions about the purpose of a prenote. A prenote is the commonly used term for an Automated Clearing House (ACH) prenotification. It is a zero dollar ACH entry that should be sent at least six banking days prior to the first live payroll credit being sent.

Under NACHA Operating Rules (also known as ACH rules), a prenote's purpose is to “validate” the routing number and account number of the receiving bank or credit union. We sometimes hear frustration from payroll professionals who send out prenotes, do not receive any negative response from the prenote, but then have the first live payroll item returned.

Prenotes are optional for the originating company, but they are not optional for the receiving bank or credit union (the RDFI, or receiving depository financial institution) once the originating company sends one. Under the ACH rules' National System of Fines, an RDFI can be fined if they do not validate prenotes sent to them.

Another confusing factor is that what we commonly



refer to as an NOC is technically a COR (correction) Standard Entry Class code. Payroll direct deposits should carry the Prearranged Payment and Deposit Standard Entry Class code.

The reality is that banks and credit unions do, in fact, validate prenotes. Smaller RDFIs (particularly credit unions) sometimes make an extra effort to review prenotes. The problem may lie with the definition of “validate”—it appears the corporate world believes the receiving bank/credit union will inspect the prenote to ensure the name and account number match. That is not the case. The RDFI is only required by the ACH rules to establish that the routing number belongs to them and the account number appears to be valid.

The Problem With Prenotes

Most larger RDFIs build ACH software edits that interrogate the information in the prenote to see if it meets their account criteria. For example, they consider the length of the account number; their checking accounts always start with specific digits, and if the account number has a check digit routine/algorithm, does it calculate properly? Therefore, a prenote may actually pass these edits and still be an invalid account:

one that is closed or has not been opened yet, or belongs to someone other than the person named in the ACH record.

The key message here is that the “A” in ACH stands for “automated” and very little human intervention is standard. When the payment does not process in an automated fashion, it can be delayed or misrouted.

Another factor is that the “perception” of the majority of RDFIs is that when they send an NOC to correct either a prenote or live dollar item, the corporate payroll department ignores it.

I understand from talking to both RDFIs and corporations that is definitely not the case, but it is a widespread perception in the RDFI community.

Part of the problem is that the dollar value of a prenote (and an NOC) is \$0 and therefore will not cause any of the parties to be out of balance. From the RDFI viewpoint, how much time and effort should they spend on dealing with a \$0 item that rejects? Particularly if the RDFI’s perception is that even if it researches the prenote and tries to correct it, the originator of the payroll item may still ignore the NOC.

Obviously, the truth lies somewhere in the middle. RDFIs do, in fact, validate prenotes and corporations do respond to NOCs. But we have to recognize that both of these “entries” have a \$0 value and have challenges. The reports that are generated for both of these transactions are sometimes not “user-friendly,” to say the least.

Prenote Benefits

Prenotes do serve as a useful quality-assurance tool; they will flush out invalid routing numbers almost immediately and will help, to some degree, with the account number and transaction code issues.

Payroll departments that use self-service methods for direct deposit enrollments may want to review their instructions on how the employee is supposed to find their bank or credit union’s routing number and account number. For example, deposit tickets are often insufficient to initiate direct deposit. Many banks and credit unions do not print their actual routing number on the deposit ticket because, unlike a check, a deposit ticket was never intended to be used outside of the bank or credit union.

Prenotes may also help in resolving issues such as employees using their savings accounts for direct deposit, but enrolling the account as if it were a checking account. RDFIs may have problems when a live ACH credit is sent with the transaction code identifying the deposit as a checking account, but the account is actually a savings account. This “mismatch” may cause the live deposit to reject and the employee’s financial institution will have to manually post the deposit. This could cause the payroll deposit to post to the employee’s account late.

The Prenote Solution

The dilemma with prenotes is a longstanding one, but your local ACH association can help. As always, feel free to contact your local ACH association for assistance—we are the ACH cops, as well as your best education resource. Visit NACHA’s Web site at www.nacha.org/map/nacha_map.html for a map of regional ACH associations and contact information.

Gary Nesbitt, AAP, is the Senior Vice President of EastPay, an ACH association serving Virginia, West Virginia, North Carolina, and Florida. Gary is also a member of the American Payroll Association’s ACH Committee.